

IN THE UNITED STATES BANKRUPTCY COURT
FOR THE SOUTHERN DISTRICT OF ILLINOIS

IN RE:)	In Proceedings
)	Under Chapter 7
C. RITCHEY SMILEY and)	
MARIE W. SMILEY,)	No. BK 84-30747
)	
Debtors.)	
FIRST NATIONAL BANK OF)	
BELLEVILLE, BANK OF)	
BELLEVILLE, BANK OF O'FALLON,)	
MURPHY-WALL STATE BANK &)	
TRUST CO., FIRST NATIONAL)	
BANK & TRUST OF ALTON,)	
FIDELITY FEDERAL SAVINGS &)	
LOAN ASSOCIATION, BANK OF)	
EDWARDSVILLE, FIRST GRANITE)	
CITY NATIONAL BANK, BANKERS)	
TRUST CO., FIRST BANK &)	
TRUST CO. OF O'FALLON,)	
COLONIAL BANK OF GRANITE))	
CITY, and STATE BANK OF)	
COLLINSVILLE,)	
)	
Plaintiffs,)	
)	
v.)	ADVERSARY NO.
)	85-0064
C. RITCHEY SMILEY and)	
MARIE W. SMILEY,)	
)	
Defendants.)	

O R D E R

This case is before the Court on an objection to discharge filed by the plaintiffs. The following facts have been agreed upon and stipulated to by the parties:

1. Prior to November 1984, defendants, C. Ritchey Smiley and Marie W. Smiley, had resided at 912 Indian Springs Road, O'Fallon, Illinois for approximately ten (10) years.

2. On October 18, 1984 plaintiff, Bank of Belleville, filed suit

in the Circuit Court of St. Clair County, Illinois against defendants in an attempt to collect the principal sum of \$350,000 alleged to be due said bank.

3. On October 31, 1984 plaintiffs met with defendant, C. Ritchey Smiley, and his counsel, Lawrence Bold (hereinafter "Bold"), to discuss a number of these obligations which had either matured, or which would mature in the near future, and to discuss loans which were in default.

4. By Warranty Deed dated October 30, 1984 signed by both defendants, defendant transferred title to their residence at 912 Indian Springs Road, O'Fallon, Illinois ("O'Fallon residence") to Lynk, Inc., a Kansas corporation, for no consideration; said deed was recorded in the St. Clair County Recorder's Office at 3:35 P.M. on October 31, 1984 in Book 2587 on Page 1671.

5. Lynk, Inc. was a corporation owned by Lynn Klein and Richard Klein, the daughter and son-in-law of defendants, and Bold was the secretary of this corporation.

6. On November 7, 1984 defendants, through their daughter and attorney-in-fact, Lynn Klein, entered into a contract for the purchase of real estate located at 19 LeMans Court, Prairie Village, Kansas ("Kansas residence") for a price of \$380,000.

7. By letter dated November 8, 1984 from Bold, defendants advised plaintiffs that they were working on a plan for repayment to plaintiffs, which plan was to be presented November 16, 1984.

8. The aforesaid letter was accompanied by statement dated October 31, 1984 regarding the assets and liabilities of defendants.

9. The aforesaid statement dated October 31, 1984 indicated as

assets a one-third (1/3) interest in a note receivable from Yong B. and Anne Kim, worth \$343,000 and the O'Fallon residence, worth \$275,000, and subject to a \$52,000 mortgage.

10. By corporation quit claim deed Dated November 9, 1984 from Lynk, Inc., signed by Richard Klein as president and by Bold as secretary, Lynk, Inc. transferred title to the O'Fallon residence back to defendants for no consideration; said deed was recorded in the St. Clair County, Illinois Recorder's Office on November 13, 1984 in Book 2588 on Page 1270.

11. On November 9, 1984 Bold contacted Citizens Bank & Trust Company of Shawnee, Kansas ("Citizens Bank"), of which Bold was Chairman of the Board of Directors, regarding the obtaining of a \$200,000 loan to purchase a residence in Kansas City.

12. On November 13, 1984 defendants obtained \$151,413.98 from Illini Federal Savings & Loan Association ("Illini Federal") by refinancing the existing mortgage on their O'Fallon residence, which had a pay-off balance of \$52,296.67, and by executing a new mortgage to Illini Federal on said residence in the amount of \$210,000, which mortgage was recorded in the St. Clair County, Illinois Recorder's Office on November 13, 1984 in Book 2588 on Page 1272.

13. On November 15, 1984 defendants obtained a \$200,000 loan from Citizens Bank by granting Citizens Bank a security interest in a promissory note dated January 6, 1983 in the amount of \$1,050,000 executed by Yong B. and Anne Kim ("Kim note").

14. On November 15, 1984 defendants closed on the purchase of the Kansas residence, paying the entire balance of the \$380,000 purchase

price with \$151,413.98 obtained from Illini Federal, the \$200,000 obtained from Citizens Bank, and cash surrender proceeds from a life insurance policy; no part of the Kansas residence was used to secure any obligation owed by defendants.

15. The aforesaid closing took place in Kansas, with defendant, Marie Smiley, present and defendant, C. Ritchey Smiley, absent.

16. On November 16, 1984 defendant, C. Ritchey Smiley, and Bold again met with plaintiffs and submitted a written proposal (the "November 16 proposal") for the liquidation of certain assets in satisfaction of the obligations due plaintiffs.

17. The November 16 proposal stated that defendants would sell, or borrow against, their one-third (1/3) interest in the Kim note and pay one-half (1/2) of the amount received for the benefit of plaintiffs.

18. The November 16 proposal stated that:

Mr. and Mrs. Smiley would like to continue owning their home. The home is subject to a mortgage in the approximate amount of \$52,000.00.

19. At the November 16, 1984 meeting, defendants, through Bold, again suggested that a bankruptcy might be filed by defendants if their proposal was not accepted.

20. At no time during the November 16, 1984 meeting did defendants disclose that they had purchased the Kansas residence, nor that they had executed a new \$210,000 mortgage on their O'Fallon residence.

21. Shortly after November 16, 1984 defendants moved the

remainder of their personal property from O'Fallon, Illinois to Prairie Village, Kansas.

22. On November 21, 1984 plaintiffs filed petitions against defendants for involuntary bankruptcy, and orders for relief on said petitions were entered January 15, 1985.

23. On February 1, 1985 defendants filed a schedule in the bankruptcy proceedings wherein they claimed as exempt, under Kansas law, the entire value of their Kansas residence, as well as all household goods, fuel, food and clothing in defendants' possession and \$500 each in jewelry.

24. On October 23, 1985 this Court ruled that defendants were not entitled to claim exemptions allowed in the State of Kansas, but were instead limited to exemptions allowed in the State of Illinois.

25. By order entered April 15, 1986, this Court approved the sale of the Kansas residence for the sum of \$360,000 and the sale of defendants' non-exempt personal property for the sum of \$23,000.

The Court makes the following findings as to controverted facts:

1. At the October 31, 1984 meeting, defendants, through Bold, proposed that plaintiffs enter into an agreement with defendant whereby plaintiffs would forbear from pursuing legal action against defendants and plaintiffs would receive forty percent (40%) of amounts due.

2. At the October 31, 1984 meeting, defendants, through Bold, stated that unless such an agreement was reached, bankruptcy was a possible alternative, in which case plaintiffs might receive less than forty (40%) of amounts due.

3. The October 31, 1984 statement indicated as an asset "Cash

Surrender Value of Life Insurance - \$9,000.00." The actual cash surrender value of the policy was \$36,000.

4. The defendants in providing plaintiffs with the October 31, 1984 statement intended to conceal the \$36,500 life insurance cash surrender value.

5. At the November 16, 1984 meeting, defendants, through Bold, again suggested that a bankruptcy might be filed by defendants if their proposal was not accepted.

6. Defendant, C. Ritchey Smiley, moved to the Kansas residence on November 16, 1984 following the meeting with plaintiffs, which was the first time this defendant personally saw the residence which he had purchased.

7. Marie W. Smiley had little or no knowledge of the business affairs of her husband, C. Ritchey Smiley, and did not know of their financial troubles until early October 1984 when rumors began to circulate concerning the Smiley's financial problems. It was at this time that she engaged a real estate agent in Kansas to secure a residence for the Smiley's. She did not attend either the October 31st or November 16th meetings.

8. The Court finds, based upon the conviction of the defendant, C. Ritchey Smiley, for a felony within ten (10) years, one involving fraud and because of the obvious inconsistencies between his testimony and that of his wife, and after observing the demeanor of the witness, that his testimony lacks credibility.

9. The acts and conduct of the defendant, C. Ritchey Smiley, as set forth above were undertaken not for the purpose of moving his

residence to Kansas but rather with the intent to preclude his creditors from reaching any assets which he owned.

DISCUSSION

The plaintiff must prove four elements before a court will deny a debtor his right to discharge under §727(a)(2)(A) of the Bankruptcy Code, to-wit: (1) a transfer or removal of property has occurred, (2) which involves the property of the debtor, (3) the transfer or removal occurred within one year prior to the filing of the petition, and (4) the debtor had, at the time of transfer or removal, intent to hinder, delay or defraud a creditor. 4 Collier Bankruptcy Practice Guide, Ch. 75, ¶75.16 (1985); In re Wolmer, 57 B.R. 128 (N.D. Ill. 1986). It is not disputed here that the defendants:

(1) Approximately three weeks before the involuntary bankruptcy petitions were filed, defendants transferred title to their O'Fallon residence to a corporation owned by their daughter and son-in-law for no consideration.

(2) Approximately 12 days before the bankruptcy petitions were filed, title to the O'Fallon residence was returned to defendant.

(3) Approximately eight days before the bankruptcy petitions were filed, the defendants encumbered the O'Fallon residence by increasing to \$210,000 an existing mortgage of approximately \$52,000, to obtain funds for the purchase of a \$380,000 Kansas residence.

(4) Six days before the bankruptcy petitions were filed, defendants assigned for security their only substantial unencumbered asset, the Kim note, to a Kansas bank as collateral for a \$200,000 loan to purchase the \$380,000 Kansas residence;

(5) Approximately five days before the bankruptcy petitions were filed, defendants removed their personal property to the State of Kansas.

Thus, the only issue left for determination is whether the debtors had, at the time of the transfer or removal, intent to hinder, delay or defraud creditors.

Whether a debtor possessed the requisite intent to hinder, delay or defraud a creditor at the time of transfer is a question of fact. In the Matter of Reed, 700 F.2d 981 (5th Cir. 1983). Plaintiff must prove actual intent, as opposed to constructive intent, which requires that the debtor himself possess a culpable purpose. Lovell v. Mixon, 719 F.2d 1373 (8th Cir. 1983); In the Matter of Reed, 700 F.2d 986 (5th Cir. 1983). However, it is well established that plaintiff neednot prove that creditors were actually defrauded, hindered or delayed. Actual injury to creditors is not an element of cause of action objecting to discharge. In Re Adeeb, 787 F.2d 1339, 1343 (9th Cir 1986); Farmers Co-Operative Association v. Strunk, 671 F.2d 391 (10th Cir. 1982).

In this case, if defendants had been successful in the transfer of their assets, Kansas exemption law would have applied and the defendants would have emerged from the bankruptcy owning all of their personal property, worth approximately \$23,000, as well as a completely unencumbered residence worth approximately \$380,000.

This Court previously decided that Kansas exemption law did not apply because defendants did not reside in that state at least 180 days prior to the filing of the bankruptcy petitions. Only the filing of the involuntary petition prevented the 180 days from running. Had plaintiffs accepted defendants' proposal for a gradual liquidation of assets, it is possible that sufficient time could have elapsed prior to

the filing of involuntary petitions to permit defendants to avail themselves of the Kansas exemption law. A debtor's actual intent to hinder or delay a creditor, even if not fraudulent, is sufficient for a denial of discharge. In Re Morris, 51 B.R. 462 (E.D. Tenn. 1985).

Further, had plaintiffs delayed in filing the involuntary bankruptcy petitions, defendants might have resided in the State of Kansas long enough for Kansas exemption law to apply. This then would have been a case of conversion of non-exempt assets to exempt assets. The Bankruptcy Act of 1898 and the Bankruptcy Code of 1978 adopt the position that the conversion of non-exempt property to exempt property, without more, will not deprive the debtor of the exemption to which he would otherwise be entitled. "The result which would obtain if debtors were not allowed to convert property into allowable exempt property would be extremely harsh especially in those jurisdictions where the exemption allowance is minimal." In Re Reed, 700 F.d 986, 990 (5th Cir. 1983). However, the court went on to state:

"The legislative history of the exemption Section does not mean that conversion is never fraudulent as to creditors, but simply that, as under prior law, mere conversion is not to be considered fraudulent unless other evidence proves actual intent to defraud creditors. While pre-bankruptcy conversion of non-exempt into exempt is frequently motivated by the intent to put those assets beyond the reach of creditors, which is, after all, the function of an exemption, evidence of actual intent to defraud creditors is required to support a finding sufficient to deny a discharge. For example, evidence that the debtor, on the eve of bankruptcy, borrowed money that was then converted into exempt assets would suffice to support a finding of actual intent to defraud." (emphasis added.)

Reed at 991. See also, In Re Collins, 19 B.R. 874 (M.D. Fla.

1982). In the case at bar, defendants, on the eve of bankruptcy, borrowed more than \$150,000 from Illini Federal and \$200,000 from Citizens Bank and used the proceeds to purchase a Kansas residence, which they then claimed as exempt property.

Because a debtor is unlikely to admit that he intended to hinder, delay or defraud his creditors, a finding of actual intent may be based on circumstantial evidence or an inference drawn from a course of conduct. 4 Collier on Bankruptcy, ¶727.02 (15th Ed. 1985); Farmers Co-Operative Association v Strunk, 671 F.2d 391, 395 (10th Cir. 1982):

"The extrinsic evidence that may indicate actual intent to defraud in the conversion of non-exempt to exempt assets includes the following: (1) that the debtor obtained credit in order to purchase exempt property; (2) that the conversion occurred after entry of a large judgment against the debtor; (3) that the debtor had engaged in a pattern of sharp dealing prior to bankruptcy; (4) that an unusually large amount of property was claimed as exempt; and (5) that the conversion rendered the debtor insolvent."

4 Collier on Bankruptcy, ¶727.02.

The evidence in this case shows: (1) That the defendants entered into an unusual course of conduct after a collection suit had been filed against them by Bank of Belleville on October 18, 1984 and other creditors began discussing the repayment of a large amount of money owed by defendants. (2) That the defendants exhibited an unusual urgency of finding and purchasing a house in a state with an unlimited homestead exemption. Defendants found a house after searching for only a few weeks and closed on the property one week later. Defendant, C. Ritchey Smiley, had not visited the residence prior to moving in. (3) Instead of using the Kansas residence as collateral for its purchase,

defendants pledged their only unencumbered asset, so that their new homestead, in addition to being an unlimited exemption, would be free and clear of liens. (4) Defendants obtained credit from Illini Federal in order to purchase an exempt asset. (5) Defendants failed to divulge to creditors that they had further encumbered their O'Fallon residence by placing a second mortgage on said home, their failure to divulge that they had assigned the Kim note to Citizens Bank, defendants' failure to divulge that they had purchased a Kansas residence and were in the process of moving their personal property to another jurisdiction, all of which took place after the first meeting of creditors on October 31, 1984 and before the second meeting of creditors on November 16, 1984. (6) The defendants represented to creditors November 16, 1984 that they would like to continue owning their home, when in reality they had already bought a new home and were planning to move all of their personal property out of the jurisdiction.

While the burden of persuasion rests at all times on the creditor objecting to discharge, it is axiomatic that the debtor cannot prevail if he fails to offer credible evidence after the creditor makes a prima facie case. The creditor's burden of persuasion does not obviate the necessity that the debtor provide a satisfactory explanation for his action. Cf. Shapiro & Ornish, 37 F.2d 403 (N.D. Tex. 1929), aff'd 37 F.2d 407 (5th Cir 1930) (debtors offered vague explanations unconvincing to bankruptcy referee or reviewing courts).

"The word 'satisfactorily[,]'...may mean reasonable, or it may mean that the court, after having heard the excuse, the explanation, has

that mental attitude which finds contentment in saying that he believes the explanation - he believes what the bankrupts says with reference to the disappearance or shortage. He is satisfied. He no longer wonders. He is contented." 37 F.2d at 406.

Here, the Court is unable to conclude the defendant has satisfactorily explained the transfer of assets. As the Court has previously concluded, the testimony of C. Ritchey Smiley lacks credibility. The record clearly shows that the actions of the defendant, C. Ritchey Smiley, were not guided by the altruistic motivations he espoused from the witness stand but rather were motivated by the intent to conceal assets from his creditors. This clearly violates 11 U.S.C. §727 and therefore discharge must be denied as to the defendant, C. Ritchey Smiley.

Because the remedy of denying discharge is a drastic one, the violation must be clear. The Court finds no such clear violation as to the defendant, Marie W. Smiley, largely because of her lack of knowledge of the business affairs of her and her husband. Therefore, plaintiffs' prayer for relief will be denied as to the defendant, Marie W. Smiley.

The Court finds for the plaintiffs and against the defendant, C. Ritchey Smiley, and for the defendant, Marie W. Smiley, and against the plaintiffs on plaintiffs' complaint. Discharge as to the defendant, C. Ritchey Smiley, is denied.

_____/s/ Kenneth J. Meyers
U.S. BANKRUPTCY JUDGE

ENTERED: March 17, 1987